

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

COMPLAINT OF GAMEFLY, INC.

Docket No. C2009-1(R)

**UNITED STATES POSTAL SERVICE REPLY TO RESPONSE OF GAMEFLY, INC.,
TO COMMISSION ORDER NO. 1700, REPORT OF SETTLEMENT COORDINATOR,
AND USPS LETTER AND NOTICE OF FILING**
(May 17, 2013)

As previously described, this case is on remand from the decision of the United States Court of Appeals, District of Columbia Circuit, in *GameFly, Inc. v. PRC*, 704 F.3d 145 (D.C. Cir. 2013).¹ Pursuant to the Commission's Order No. 1700,² on April 23, 2013, the Public Representative, the Postal Service, and GameFly attended a settlement conference led by a Settlement Coordinator appointed by the Commission. Based on this conference, on May 6, 2013, the Settlement Coordinator issued a report.³ On May 3, 2013, the Postal Service submitted a letter to GameFly "describ[ing] the Postal Service's position regarding the processing of GameFly's DVD mail, if it were to be submitted as letters eligible for the First-Class Mail one-ounce letter rate."⁴ More specifically, the letter states that "[t]o the extent possible and practicable, the Postal Service is prepared to process GameFly letters using methods that avoid letter machine processing to substantially the same degree experienced by DVD mail submitted by

¹ See United States Postal Service Reply in Opposition to Motion of GameFly, Inc. to Establish Standards and Procedures to Govern Proceedings on Remand, PRC Docket No. C2009-1, at 1-2 (March 14, 2013) ("March 14 Reply").

² Order Convening Settlement Conference, Order No. 1700, PRC Docket No. C2009-1(R) (April 16, 2013).

³ Report of Settlement Coordinator, PRC Docket No. C2009-1(R) (May 6, 2013).

⁴ United States Postal Service Notice of Filing, PRC Docket No. C2009-1(R) (May 6, 2013).

other mailers who present mail with similar packaging that qualifies for the letter rate.”⁵

On May 6, 2013, the letter became part of this docket.⁶

On May 13, 2013, GameFly filed a twenty-eight page “response,” repeating its March 7, 2013 request for an order permitting it to pay the one ounce letter rate for mailing two ounce First-Class Mail flats, or an equalized rate between the one ounce letter rate and its current discounted rate, for two ounce flats. GameFly also reiterated its inaccurate contention that the Court’s opinion has eliminated the Commission’s remedial authority to impose any remedy other than the one favored by GameFly.⁷ As noted before, the demands GameFly describes embody its preference to eliminate the Commission’s discretion and remedial authority, and prevent it from opening the record, or otherwise collecting input or guidance regarding the steps necessary to make an informed decision on remand.

As explained previously,⁸ the establishment of a new rate-based remedy would require reopening the record. The preferred remedy would enshrine an unacceptable principle, namely, that any mailer who chooses to avail itself of the handling, processing, and cost incurrence generally associated with a particular category of mail or type of mail service is entitled to the lower rate available for a completely different category of mail, with different handling, processing, and costs, based solely on the hypothetical allegation that, if it were to mail under the classification represented by the lower rate, the mailer’s mail would not receive the same processing received by mail

⁵ *Id.*

⁶ *Id.*

⁷ Response of GameFly, Inc., to Commission Order No. 1700, Report of Settlement Coordinator, and USPS Letter and Notice of Filing, PRC Docket No. C2009-1(R) (May 13, 2013).

⁸ March 14 Reply, at 3-4.

from different mailer. The eligibility for this rate treatment would rest on Postal Service decisions to treat the mailings of different mailers, with different physical characteristics and mailing patterns, differently, even if those differences are fully justified according to local decisions regarding costs and operational requirements and feasibility. Stated more simply, GameFly seeks establishment of a legal principle that payment of any particular rate for mail controls how such mail must be processed.

In contrast to GameFly's preferred remedy, a remedy modeled after the Postal Service's May 3, 2013 letter would comply with 39 U.S.C. § 403(c), 39 U.S.C. § 3662(d), and the Court's opinion. It would eliminate any unreasonable discrimination prohibited by 39 U.S.C. § 403(c), and it would provide that the same mail processing policies regarding avoidance of automated letter processing for DVD mail be applied to DVD mailers.

Finally, to the extent that the Commission decides to impose a remedy other than the original remedy, or a remedy modeled after the Postal Service's May 3, 2013 letter, it should not be bound by the inaccurate, baseless, and self-serving restrictions on the Commission's remedial authority concocted by GameFly. A remedy that eliminates or explains unreasonable "terms of service" discrimination will satisfy 39 U.S.C. § 403(c), 39 U.S.C. § 3662(c), and the Court's opinion.

The Postal Service respectfully requests that the Commission reject the remedy and remedial limitations favored by GameFly, and respond to the Court's remand in a manner that either seeks approval of the original remedy, or encourages informed consideration of a diverse set of alternative remedies and justifications, including a remedy modeled after the Postal Service's May 3, 2013 letter.

I. GAMEFLY’S FAVORED REMEDY, OR ANY NEW RATE-BASED REMEDY, CANNOT BE ESTABLISHED WITHOUT REOPENING THE RECORD.

As previously explained,⁹ and contrary to GameFly’s assertions, the Commission does not have *carte blanche* to impose a remedy disconnected from the existing record, sound procedures, or applicable laws, including the very statutory policies on which the Commission’s original findings of discrimination are based. GameFly’s repeated references to “law of the case” do not absolve the Commission from the obligation to base a remedy on accurate facts and unassailable legal principles. In particular, the Commission cannot ignore material changes in facts due to changed circumstances, or sweep away the factual and policy implications of its remedial order, including the effect on the Postal Service’s finances.

Summary adoption of the rate GameFly advocates would be unsupported by the record or fair procedure. In this regard, we note that, in its original Order the Commission found that “[GameFly’s estimates of cost differences between Netflix and GameFly round-trip mailers] are not sufficiently accurate to be used to design a rate for flat-shaped round-trip DVD mailers”¹⁰ Without further exploration on the record, reversal of this conclusion would be devoid of legal and factual support.

GameFly’s contentions that “the cost differences between letters and flats are irrelevant as a matter of law” and that “reopening the record ‘to develop supplemental or revised cost data to address the deficiencies in the then-record data’ on those cost differences would be arbitrary and unlawful”¹¹ reflect an inaccurate and misleading interpretation of the Court’s decision, and ignore the potential impact of a remedy on the

⁹ *Id.*, at 5-6.

¹⁰ Order at 112, ¶ 5019.

¹¹ GameFly Response at 6 (internal citation omitted).

Postal Service's operations, rate and classification schedules, and the implications for all mailers.

First, the Court did not hold that “cost differences between letters and flats are irrelevant as a matter of law” or that “cost and operational differences between letter- and flat-shaped mailers cannot justify charging GameFly more than Netflix for the same avoidance of automated letter processing.”¹² Instead, the Court's opinion states that “[t]he Commission cannot justify the terms of service discrimination its remedy leaves in place (providing manual letter processing to Netflix but not to GameFly) based on the companies' use of different mailers when the use of different mailers is itself the product of the service discrimination.”¹³ It considers “terms of service discrimination” in mail processing – “providing manual letter processing to Netflix but not to GameFly” – and makes no reference to any discrimination with respect to pricing.¹⁴ And, in stark contrast to GameFly's apparent misinterpretation of the Court's opinion as holding that all “cost differences . . . are irrelevant,” the Court identified only one factor – “the companies' use of different mailers” – that is unlawful for the Commission to cite as justification for any “terms of service discrimination [that a] remedy leaves in place.”¹⁵

Notwithstanding the conflict between GameFly's representations and the language of the Court's opinion, GameFly's assertions regarding the alleged irrelevancy of cost considerations reflect a perspective limited to the interests of DVD mailers and ignore potential implications for the postal community as a whole. GameFly appears to

¹² *Id.*

¹³ *GameFly, Inc. v. PRC*, 704 F.3d 145, 149 (D.C. Cir. 2013).

¹⁴ *Id.*

¹⁵ *Id.*

view its statement that “a pricing remedy, rate equalization, [] completely eliminates the financial injury, and requires no operational changes by the Postal Service or operational oversight by the Commission,”¹⁶ as demonstrating the superiority of its preferred remedy. But, this statement, even if true (It is not.), does not address compliance with the provisions and policies of the PAEA and the Commission’s own regulations, a central consideration for any assessment of a rate’s lawfulness. Although GameFly dismisses the risk of another mailer’s challenge to its preferred remedy, under the Commission’s very broad definition of term “similarly situated,” which evidently includes two mailers that do not compete, and that utilize completely different mail products, it is possible for non-DVD flats to be considered similarly situated to GameFly. The allegation that no “other sender of flat-shaped mail challenged the [current] remedy as discriminatory,”¹⁷ does not demonstrate the lawfulness of GameFly’s preferred remedy, or the likelihood that it will avoid embodying unreasonable discrimination and consequent challenge by other mailers

Like GameFly’s inaccurate statements regarding the relevance of cost considerations, there is no basis for GameFly’s assertion that “reopening the record ‘to develop supplemental or revised cost data to address the deficiencies in the then-record data’ on those cost differences would be arbitrary and unlawful.”¹⁸ And, GameFly’s own pleading contradicts its assertion that its preferred remedy would not require additional record support by conceding that a rate equalization remedy would require additional

¹⁶ GameFly Response at 16.

¹⁷ *Id.* at 21.

¹⁸ *Id.* at 6.

evidence, specifically “a projection of the resulting average revenue per piece of First-Class Mail in the aggregate.”¹⁹

Even under GameFly’s interpretation, it would be appropriate to reopen the record to consider GameFly’s preferred remedy, because imposing that remedy, without reopening the record, would itself embody discrimination against other mailers that cannot be justified in light of current operations, changed circumstances, and the application of sound policies. At a minimum, the Postal Service’s position described in its May 3 letter, as well as the changed circumstances and operational realities that underpin it, have altered the factual and legal landscape in which the Commission’s action now takes place.

On this point, the Postal Service again notes that the processing of mail pieces containing DVDs, as well as major parts of the operating environment, have changed since the existing record in PRC Docket No. C2009-1 was established. As the Commission is well aware from the recent service-change dockets reviewing substantial operations changes, circumstances are changing substantially in response to declining volumes and operational needs. In light of these changes, as well as shifting mailer preferences and expectations regarding the processing of their mail, sound policy and law militate decisively in favor of further exploration on the record, before a remedy is imposed.

¹⁹ *Id.* at 22.

II. AN OPERATIONAL REMEDY MODELED AFTER THE OPERATIONAL POLICY DESCRIBED IN THE POSTAL SERVICE'S MAY 3, 2013 LETTER WOULD COMPLY WITH 39 U.S.C. § 403(C), 39 U.S.C. § 3662(C), AND THE COURT'S OPINION.

Compliance with 39 U.S.C. § 403(c), 39 U.S.C. § 3662(c), and the Court's opinion requires that a remedy produced through this docket must be focused on the elimination of unreasonable discrimination. In rejecting operational remedies that would provide GameFly DVD mail with the same mail processing treatment as the DVD mail of letter DVD mailers, GameFly reveals that it seeks a remedy that serves interests other than the elimination of discrimination. Specifically, GameFly seeks a remedy that provides it with mail processing treatment superior, rather than equal, to the treatment received by other mailers in the form of lower rates, more expensive and valuable mail processing methods, guaranteed avoidance of DVD breakage, and control over Postal Service decisions regarding application of mail processing methods.²⁰ No mailer has ever wielded the degree of control over Postal Service operations sought by GameFly.

²⁰ GameFly's repeated references to "irreparable" injury should be disregarded and should play no role in the fashioning of a fair remedy. GameFly's estimates are based solely on the improper hypothetical construct on which its allegations are based. Notwithstanding the Commission's findings, the Postal Service continues to assert that this approach represents a fatal defect in GameFly's standing and its status under the statutory discrimination provision, pursuant to sound legal principles of jurisdiction and administrative law. Far from representing injury, GameFly's incurrence of postage reflects the proper application of postal rates. GameFly has chosen to pay for First-Class Mail flats service with reinforced mailpieces up to two ounces. It has received that service. In fact, recent information indicates that, as a practical matter, GameFly's mail often receives enhanced service, and is manually culled, avoiding even flats machine processing. Furthermore, as a result of the Commission's first remedy, since 2011, it has been relieved from paying the second-ounce charge. Based only on data representing the period since FY 2012, this difference appears to have cost the Postal Service over a million dollars in revenue. Moreover, the improper hypothetical assumption reflects what GameFly claims it would have done. As explained above, the Postal Service is prepared to provide GameFly with operational treatment meeting GameFly's principal objections. That fundamental change should control.

A. To Comply with 39 U.S.C. § 403(c), 39 U.S.C. § 3662(c), and the Court's Opinion, It Is Not Necessary for a Remedy to Include GameFly's Preferred Enforcement Mechanism.

Although GameFly alleges that “neither the Commission nor the Postal Service has identified any alternative to the rate equalization remedy proposed by GameFly that comes close to satisfying Sections 403(c) and 3662(c), and the D.C. Circuit mandate,”²¹ GameFly's overriding objection to potential operational remedies presented in this docket reflects a fear of breakage, not concerns about discrimination. Accordingly, GameFly focuses on concerns about the inadequacy of enforcement mechanisms desired to ensure that its mail would be processed manually at a high rate.²² But, by focusing on breakage, GameFly's arguments stray from the issue central to the Commission's decision in this docket – the elimination of unreasonable discrimination.²³

To comply with 39 U.S.C. § 403(c), 39 U.S.C. § 3662(c), and the Court's opinion, a remedy must eliminate the terms of service discrimination in mail processing, or justify any residual discrimination left in place by the remedy.²⁴ DVD breakage is a separate issue and is the responsibility of the mailer, and not the Postal Service. For example, a remedy requiring all DVD letter mail to be processed on automated letter machines, or establishing a low uniform rate of manual processing, would likely comply with 39 U.S.C. § 403(c), 39 U.S.C. § 3662(c), and the Court's opinion. And, if application of this

²¹ *Id.* at 1.

²² *Id.* at 10-11. Because GameFly's DVDs have a significantly higher cost than the video DVDs mailed by DVD letter mailers, it is likely that the level of manual processing acceptable to GameFly would be significantly higher than the level acceptable to video DVD letter mailers. See Initial Brief of the United States Postal Service, PRC Docket No. C2009-1, (November 8, 2010) at 72-73.

²³ In this regard, it bears repeating that there is no legal principle that guarantees any mailer freedom from the risk of breakage, or the entitlement to any particular type or level of mail processing. Any remedy based on the opposite conclusion would be defective.

²⁴ *GameFly*, 704 F.3d at 149.

policy resulted in DVD letter mailers receiving different levels of manual processing, there would be no violation of 39 U.S.C. § 403(c), 39 U.S.C. § 3662(c), or the Court's opinion, unless the factors supporting the different levels of manual processing were unreasonable. A remedy produced by this docket must only eliminate unreasonable discrimination and/or justify residual discrimination left in place by the remedy. In this regard, the Commission is authorized to fashion a remedy that respects operational and financial conditions, even if it does not impose the specific enforcement mechanism GameFly prefers.

B. Previous Statements Regarding the Feasibility of an Operational Remedy Do Not Reflect Current Operational Conditions of the Postal Service.

GameFly offers previous statements of the Postal Service and Commission as support for its claim that an operational remedy is not feasible,²⁵ but these statements do not reflect current operational conditions or current statements of the Postal Service. As described above, postal operations are evolving substantially, in light of changing policies and operational requirements associated with the need to adapt, financially and operationally, to declining volumes and shifting mailer preferences and expectations regarding the processing of their mail. This evolution includes the utilization of new mail processing machines, and the increased use of Intelligent Mail barcode technology. GameFly criticizes the Postal Service for “proffer[ing] no evidence whatsoever that the rate of manual processing of Netflix DVDs has changed significantly since 2010,”²⁶ but seeks to foreclose an opportunity for the Postal Service to demonstrate a change in circumstances through a reopening of the record.

²⁵ GameFly Response at 9-14.

²⁶ *Id.* at 25.

Finally, the statements of the Commission and the Postal Service regarding an operational remedy address a potential remedy different from that described in the May 3, 2013 letter. Despite GameFly's characterization of the letter as presenting "a warmed-over version of the terms set forth in the Postal Service's letter to GameFly on May 17, 2010,"²⁷ there are important differences. Most importantly, the May 17, 2010 letter focuses on manual processing, while the May 3, 2013 letter focuses on avoidance of automated letter processing.²⁸ The policy described in the May 3, 2013 letter would provide the Postal Service with more flexibility to consider a broader range of mail processing options and changes in operational conditions and the mail processing network when determining, on a local basis, appropriate, efficient, and nondiscriminatory processing methods for DVD mail. Furthermore, the previous statement contained in the May 17, 2010 letter would have imposed restrictive conditions designed to ensure that the cost and operational burdens created by treating GameFly mail comparably to other DVD letter mailer would be minimized. The May 3 statement contains only one operational condition, which GameFly has already accepted.²⁹ In this regard, the Commission cannot ignore this material change in relation to the Court's expectations on remand.

²⁷ *Id.* at 9.

²⁸ Compare Letter from R. Andrew German to David M. Levy (May 17, 2010) with Letter from Kevin A. Calamoneri to David M. Levy (May 3, 2013).

²⁹ Post-Hearing Brief of GameFly, Inc., PRC Docket No. C2009-1 (November 8, 2010) at 62-64 ("If the Postal Service provided Netflix levels of manual processing to GameFly pieces entered at machinable letter rates, GameFly hereby stipulates that it would be willing to enter its pieces as letters, and to mark the pieces more brightly and conspicuously"); Reply Post-Hearing Brief of GameFly, Inc., PRC Docket No. C2009-1 (November 29, 2010) at 35 ("If ... the Postal Service offered letter-rated DVD service on terms comparable to those now offered to Netflix, GameFly would be perfectly willing to enter its DVDs in brightly colored and highly visible letter-sized pieces at letter rates").

C. It Is Not Necessary for the Commission's Remedy to Restrict Postal Service Discretion Over the Processing Methods Applied to DVD Mail.

GameFly appears to believe that, to comply with 39 U.S.C. § 403(c), 39 U.S.C. § 3662(c), and the Court's opinion, an essential element of any operational remedy is the removal of Postal Service discretion to select the most appropriate methods of mail processing based on local conditions, and a requirement that specific mail processing methods be applied to mail of a particular shape or associated with a particular rate. Paying a particular rate or submitting mail of a particular shape has never entitled a mailer to a particular method of processing. Adopting this as a legal principle would set a dangerous and legally indefensible precedent. Deference to local decisions regarding mail processing methods is an operations principle that is widely understood and accepted by mailers and the postal community as a whole, and lies at the heart of the Postal Service's statutory authority to direct postal operations. The Commission's original remedy respected that principle. It should not be swept aside now.

GameFly's argument, in section II.A.2. of its Response, highlights GameFly's misunderstanding regarding the connection between a rate or mail shape and mail processing methods. In this section of its Response, GameFly addresses the Commission's proposal to "collect a non-machinable surcharge on all letter-shaped DVD mail" and "impose the full charge for the second ounce of First-Class DVD flats mail."³⁰ GameFly concludes that "[w]ithout a requirement of parity in manual processing between GameFly and Netflix DVDs entered as letters, the remedy would be

³⁰ Order No. 1700, Order Convening Settlement Conference, PRC Docket No. C2009-1(R), Appendix at 2 (item III.b).

unlawful.”³¹ But, hypothetically, if it was determined that unlawful discrimination resulted from the failure to impose a nonmachinable surcharge on nonmachinable DVD mail, application of that surcharge could hypothetically eliminate the discrimination.³² There is no requirement that the Postal Service use a particular processing method for nonmachinable DVD mail, and it is permitted to apply local discretion to determine appropriate processing methods. Based on a reasonable assessment of local operational conditions, it could be determined that nonmachinable DVD mail of different mailers should be processed differently. This determination would be unlawful only if the application of different processing methods was unreasonable.

D. It Is Not Necessary for the Commission’s Remedy to Address the Pricing and Processing of All DVD Mailers.

Despite the fact that GameFly’s complaint raises issues that appear to concern only a subset of DVD mailers, it seeks a remedy that would bar any other DVD mailer from paying a lower rate than GameFly. Specifically, GameFly states that any rate equalization remedy that produces a rate above the rate for “generic letter-shaped First-Class Mail” must “render DVDs ineligible for those generic rates.”³³ This would lead to a rate increase for letter DVD mailers that have adapted their business models to Postal Service operational policies, and developed packaging and mailing practices that are compatible with processing on automated letter machines. GameFly seeks to punish

³¹ GameFly Response at 7.

³² The Postal Service strongly emphasizes that existing nonmachinable criteria are established by regulation. The Commission cannot arbitrarily revise those standards, with implications for application of the surcharge impacting all mailers, without, at a minimum, a solid basis in the record. That basis does not currently exist. If the Commission were to arbitrarily determine that a particular mailer’s mailpieces were nonmachinable, and direct the imposition of a surcharge, its determination would have to be evaluated under a strict standard.

³³ *Id.* at 16.

these mailers for pursuing the innovation and investment in their business operations that GameFly has disregarded.³⁴ GameFly's attempt to obtain a remedy that would punish more innovative DVD mailers offers further evidence of GameFly's self-serving purpose in this litigation, and its greedy and disproportionate demands.

III. CONCLUSION

For the reasons set forth above, the Postal Service requests that the Commission deny the relief requested in GameFly's Response. On remand, the Postal Service submits that the Commission can consider alternative remedies only if it reopens the record. Substantive and procedural legal standards, as well as sound policy, would support that approach. Alternatively, the Commission should defend its original remedy by providing further explanation based on evidence already in the record.

Respectfully submitted,

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³⁴ See Postal Service Initial Brief at 73.